

TO: State Directors
Rural Development

ATTENTION: Program Directors, MFH Program Directors or Coordinators

FROM: Arthur A. Garcia *(Signed by Arthur A. Garcia)*
Administrator
Rural Housing Service

SUBJECT: Program Related Issues for MFIS3 Training

PURPOSE/INTENDED OUTCOME:

The implementation of the third version of the Multi-Family Housing Information System (MFIS3) gives the Agency an improved automated system to better manage the Multi-Family Housing (MFH) portfolio. The Agency now has a new opportunity to update and improve our internal management processes to take advantage of our expanded automation capabilities. Our goal is to assure that the MFH portfolio continues to deliver decent, safe and sanitary affordable housing well into the future. This Administrative Notice (AN) provides an overview of MFH program administration changes that you are to implement within your jurisdiction as your offices convert to MFIS3.

COMPARISON WITH PREVIOUS AN:

This AN updates and replaces RD AN No. 3552(1930-C), dated May 30, 2000, which expired on December 31, 2000.

IMPLEMENTATION RESPONSIBILITIES:

When State and Servicing Offices convert to MFIS3, the following changes are to be implemented within their jurisdiction:

EXPIRATION DATE: November 30, 2003

FILING INSTRUCTIONS
Preceding RD
Instruction 1930-C

A. Changes to the oversight and access of MFH program information. MFIS3 provides direct access by all MFH staff to scheduling, tracking, monitoring, supervision and servicing information maintained by the Servicing Office. This access allows the Agency to provide better management and oversight of the portfolio and to eliminate several time consuming information collection efforts. For example, the paper based Form RD 1930-10, "Annual Multiple Family Housing Project Review," review process is replaced by MFIS3 monitoring routines. The annual collection of national tenant information is done without field office intervention. **Attachment A** provides more information on how MFIS3 reports will be used to improve program oversight. **Attachment A-1** documents Agency review responsibilities for MFIS3 reports.

B. An improved MFH classification process. The increased capacity of MFIS3 to provide detailed servicing information allows the Agency to improve our classification system and focus on projects which Servicing Offices consider truly at risk. **Attachment B** provides a guide to the classification system. A current reference listing of supervisory activities, servicing efforts and findings is available on MFIS3 on-line help.

C. Changes to supervisory visit requirements. As part of the ongoing regulatory revision process, the supervisory visit form was improved to allow the Agency to review borrower compliance with specific performance standards. Data from Form RD 1930-11, "MFH Physical Inspection Report" will be entered into MFIS3 and used in the monitoring and classification process. The requirement for an annual review of a project's physical status will continue. **Attachment C** describes the physical inspection form and discusses the annual visit. Also recommended by the regulatory revision process is a new project management and occupancy review format. MFIS3 generates a report that defines this format. Servicing Offices may use this report as a voluntary field test of the reporting format.

D. Change to the project budget approval process. MFIS3 provides for a much stronger analytical process. Budget data can be analyzed on-line or through reports. A predetermined analysis process is available to highlight key financial issues. In addition, Form RD 1930-7, "Multiple Family Housing Project Budget," includes a new "part" to record planned capital expenditures. **Attachment D** provides an explanation of its use, and **Attachment D-1** documents the issues analyzed by MFIS3. A description of the budget norms is available on MFIS3 on-line help.

E. Reserve account issues. To assure a standard approach to tracking the use of reserve account funds, **Attachment E** reviews reserve account issues relevant to the implementation of MFIS3. MFIS3 also has the capacity to record the results of a capital needs assessment which is permitted in accordance with RD Instruction 1930-C, Exhibit B, paragraph X.

F. Change to the review of actual project operating income and expense figures. MFIS3 prepares an analysis of information submitted by the borrower when they provide audited actual budget figures after the end of each fiscal year. **Attachment F** discusses the impact of the analysis and **Attachment F-1** documents the issues analyzed by MFIS3.

Attachments

Oversight and Access of MFH Program Information

Oversight and Access of MFH Program Information:

1. MFIS3 is to be used as the only MFH program tracking system.
2. The review and analysis of MFIS3 information replaces the Form RD 1930-10 annual paper based review process.
3. Program managers and reviewers will use MFIS3 as a primary source of information to provide oversight of Servicing Office actions.
4. The Agency will use MFIS3 to collect tenant and project information and provide it to outside parties in support of the MFH program.

Discussion:

1. MFIS3 is to be used as the tracking tool for all MFH supervisory and servicing actions. State and Servicing Office staff should discontinue using ad-hoc tracking systems that duplicate processes contained within MFIS3. To understand what MFIS3 tracks, the following is a quick reference to key MFIS3 terminology:
 - ***Supervisory activities*** are actions the Agency takes to supervise borrowers, projects, and tenants. They include ***inspections***, where the Agency physically inspects the project, such as during a supervisory visit or ***reviews*** where the Agency examines a document or budget submitted by a borrower.
 - ***Servicing efforts*** are actions to correct problems or address ownership issues. They include ***actions*** taken by the Agency, such as sending a servicing letter to correct a problem, or ***requests*** by the borrower and processed by the Agency, such as a borrower request for a transfer.
 - ***Financial Instruments*** are documents provided by borrowers with financial information required by the Agency to monitor the financial status of MFH projects. These include Forms RD 1930-7 and 1930-8.
 - ***Tracked accounts*** are borrower held project financial accounts monitored by the Agency, such as the reserve account.
 - ***Findings*** are instances where the Agency “finds” that the borrower is not operating in accordance with regulations, laws, or loan agreements. ***Violations*** are findings elevated by their severity or the Agency’s inability to resolve them thorough routine contacts with the borrower. Attachment B contains more information on findings and violations and how they relate to a project’s classification.
 - ***Tracking steps*** are milestones used to track the progress in performing supervisory activities or servicing efforts.

- 2 Using the tracking, analytical, and comment capabilities of MFIS3, State and Servicing Offices can review and analyze all the information currently contained on Form RD 1930-10. When MFIS3 capabilities are used, the requirements of RD Instruction 1930-C, regarding the use of Form RD 1930-10 will be met. This AN re-establishes the review, analysis, and comment process to be used, thus eliminating the need for the form.
- 3 Program and staff managers in the National, State, and Servicing Office are to use MFIS3 reports to determine where problem areas are located, if trends are isolated or widespread, the location of Agency offices that could use help, and the training needs of the Agency or borrowers. A complete listing of MFIS3 reports will be available in the MFIS3 training manual.
- 4 MFIS3 improves the Agency's reporting capabilities because of the direct access to program data from all administrative levels of the Agency. The Agency now has a faster and less burdensome method for providing information to Congress and outside parties on the status of our portfolio, its strengths and weaknesses, and other information relative to supporting the future viability of the MFH program.
- 5 MFIS3 reporting has greatly improved report capabilities. These capabilities will be described in detail during MFIS3 training. Beginning with the implementation of MFIS3, each Servicing Office will be able to access and generate reports on information within their jurisdiction and the State Office will be able to access its Statewide information as well as receive information by Servicing Office jurisdiction.

Procedural Reference:

1. RD Instruction 1930-C, Section 1930.117 (a) (12) requires each State to gather, maintain, analyze, and distribute a database of actual MFH operation and maintenance expenses. When implemented in each State, MFIS3 will be used as the database for maintaining, and analyzing project financial information as well as recording and tracking project supervisory activity and servicing efforts.
2. RD Instruction 1930-C, Section 1930.123 (g)(1) requires that State Directors review all submissions of Form RD 1930-10 by the Servicing Office to record summary results of the annual project status review. When MFIS3 is implemented in each State, the paper based annual review on Form RD 1930-10 will be replaced with an automated process using information available on MFIS3. Relevant servicing information will be reviewed using MFIS3 on-line and reporting capabilities.
3. RD Instruction 1930-C, Section 1930.117 (c)(1) requires State staff to continuously monitor supervisory and account servicing activities and borrower status to assure that each project is receiving timely and effective supervision. When implemented in each State, MFIS3 will be used to accomplish monitoring responsibilities.
4. RD Instruction 1901-E, Section 1901.202(g) requires the Rural Development to maintain racial and ethnic data showing the extent to which members of minority groups are beneficiaries of Rural Development assisted programs. MTFS has been converted into the MFIS3 database and MFIS3 will be used for this responsibility. Reports can be run using tenant data centralized on the server in St. Louis. In addition, RD Instruction 2018-F, Section 2018.257 states that to speed processing, requests for information should be made to the appropriate County, District or State Office where the records are likely to be located.

Implementation Directions:

1. State and Servicing Offices are to use MFIS3 as the primary tracking and monitoring tool for the MFH program. If there is a local system that can not be replaced upon implementation of MFIS3, the Multi-Family Housing Portfolio Management Division (MHPMD) is to be notified.
2. At least quarterly, State Offices are to print out and review the project classification report. For projects classified with a D or C, State Offices are to review the project's supervisory and servicing status on MFIS3, using either reporting or on-line capabilities to determine the nature of the finding, violation, or default, and the extent of Servicing Office efforts to resolve the problem. State Offices are then to coordinate with the Servicing Office to assure that an effective servicing strategy is in place to correct the problem. The State Office should retain sufficient paper documentation of this annual review process to assure that future reviewers will be able to determine that the appropriate annual review and coordination efforts were performed.
3. Attachment A-1 is a list of reports that may be reviewed in each Servicing and State Office, as well as the National Office, as part of an effective monitoring routine. When appropriate, documentation of the report reviews conducted in each Servicing and State Office should be retained in each office's operational files. The reviewer's signature, any comments, and date reviewed should be entered on the printout to document the review had been completed. Actual monitoring practices may be modified to fit the needs of each office.
4. National Office requests for information regarding the status of the MFH portfolio will now be limited to information that is not available from MFIS3 or from data on the new centralized MTFS database.

MFIS3 Reports and Review Responsibilities

Servicing Office review responsibilities listed below are to be completed periodically by the RDM or Specialists responsible for MFH in each Servicing Office to assure accurate data and positive trends in servicing.

REPORT #	REPORT NAME	REPORT PURPOSE
BOR1000	Borrower Identification and IOI	This report lists Borrowers based on effective dates. Includes current borrower membership, borrower detail information, projects they are currently managing and any IOI designations indicated for the management agent.
BOR2000	Borrower / Project Identification	This report lists each Borrower, projects they own and basic project information. Basic information includes Name, case number, address, classification, rental code, #revenue producing units, #R/A units, #vacant units, and fund code.
FIN1500	Budget Norms Summary	This report is used to print in one place the Average Norm and Standard Deviation of each Norm Template calculated for the selected project for the selected fiscal year.
FIN3100	Project Initial Operating Capital Summary (2%)	This report is used to review the status of 2% tracked accounts. It displays for each project that has a 2% account the Initial balance, the current balance, the date of the last transaction processed against the account and the age of the account. You may include all 2% accounts (open and closed) if desired. Ant 2% account greater than 12 years old will be closed.
FND1000	Project Findings	This report is used to display all the findings associated for a project. For each finding the date the finding was opened, the current status of the finding, if the finding is considers a violation, and if the finding is associated to a supervisory activity and / or a servicing effort is displayed.
MGMT2000	Management Agent / Project Identification	Report lists management agent name, contact, phone, address, project name, case number, project address, classification, rental code, revenue producing units, number RA units, number vacant units, and fund code.
PRJ2000	Project Worksheet	Provides project worksheets on projects.
PRJ3000	Project Classification	Report list project classifications by state, servicing office, and/or county.
PRJ5000	Project Management Agent/Borrower History	Report provides history will list classification history by individual property, or the report can be run to show classification of properties managed by a particular management agent or borrower.
PRJS2000	Subsidy Status Report	Report provides status of subsidy for projects including # revenue units, # vacant units, # paying overage, # overburdened, # deep subsidy used, # RA units, # RA unused, Avg. basic note and HUD rents, # zero income tenants, and RA due tenants.
PRJS3000	Rent Change Summary Report	Report shows history of rent changes. It can be run by management agent or borrower. History detail includes; Months between change, months at current rate, current basic note and HUD rents, utility allowance, change in % to basic note and HUD rent, % change to utility allowance, \$ change to basic, note, HUD, and utility allowance.
PRJS3100	Utility Allowance Change Summary	Report shows history of changes in utility allowances including; gas, electric, water, sewer, trash, and other. It tracks the amount of the allowance and the % and \$ amounts of changes.
PRJS4000	Status of Vacant Units	Report tracks the status of vacant units by project, borrower, and/or management agent. The report shows the project, classification, unit # vacant, unit BR size, Vacant date, # months vacant, and if unit habitable.

PRJS4100	Vacancy Summary Report	Report shows # revenue producing units, Total vacant units, Vacant %, Total RA units, Unused RA units, % Unused RA, # tenants vacating this month, and tenants moving in this month. The report can be run by project, borrower, management agent, field office, or state.
PRJS4200	Occupancy Trend Report	This report displays up to 12 months of history on a project covering a number of projects. All categories are for the total counts/amounts for the project. The categories are selectable and include; # tenants vacating, # tenants moving in, # vacant units, # unused RA units, Amt. overage, amt., RA request, amt. payment due, amt. RA check due, amt. excess HUD payments, # expiring certificates, # tenants paying over 30%, NTC.
TRK1000	Supervisory Activity Tracking	Report provides summary count and status of supervisory activities. It lists the type of activity (ex. 1930-7, AFHMP, Audit, Balance sheet, each type of inspection and review, insurance, servicing contact, etc.) and whether overdue, due, contact, complete, received, follow-up, reviewed, approved, expired, rejected.
TRK2000	Servicing Effort Tracking	The first summary shows total count of projects by state, servicing office, and county. The second summary shows counts by servicing efforts. The summary report shows total number of servicing efforts and the count is divided between each available tracking step possible for all servicing efforts.
TRK3000	Tracking Step Summary Report	This report is used to show all projects and the status on each tracking step associated to a specific type of supervisory activity.

MFIS3 Reports and Review Responsibilities (Continued)

State Office review responsibilities listed below are to be completed by the Program Manager or Specialists responsible for MFH in each State Office. State Director's are to review these reports periodically to assure accomplishment of MFH goals. In addition, **National Office** Program Managers and Specialists will review these reports to monitor the servicing status of the MFH portfolio.

REPORT #	REPORT NAME	REPORT PURPOSE
FIN1500	Budget Norms Summary	This report is used to print in one place the Average Norm and Standard Deviation of each Norm Template calculated for the selected project for the selected fiscal year.
FND1000	Project Findings	This report is used to display all the findings associated for a project. For each finding the date the finding was opened, the current status of the finding, if the finding is considers a violation, and if the finding is associated to a supervisory activity and / or a servicing effort is displayed.
PRJ3000	Project Classification	Report list project classifications by state, servicing office, and/or county.
PRJS2000	Subsidy Status Report	Report provides status of subsidy for projects including # revenue units, # vacant units, # paying overage, # overburdened, # deep subsidy used, # RA units, # RA unused, Avg. basic note and HUD rents, # zero income tenants, and RA due tenants.

PRJS4100	Vacancy Summary Report	Report shows # revenue producing units, Total vacant units, Vacant %, Total RA units, Unused RA units, % Unused RA, # tenants vacating this month, and tenants moving in this month. The report can be run by project, borrower, management agent, field office, or state.
TRK1000	Supervisory Activity Tracking	Report provides summary count and status of supervisory activities. It lists the type of activity (ex. 1930-7, AFHMP, Audit, Balance sheet, each type of inspection and review, insurance, servicing contact, etc.) and whether overdue, due, contact, complete, received, follow-up, reviewed, approved, expired, rejected.
TRK2000	Servicing Effort Tracking	The first summary shows total count of projects by state, servicing office, and county. The second summary shows counts by servicing efforts. The summary report shows total number of servicing efforts and the count is divided between each available tracking step possible for all servicing efforts.
TRK3000	Tracking Step Summary Report	This report is used to show all projects and the status on each tracking step associated to a specific type of supervisory activity.

Classification Process

Program Changes:

1. MFIS2 established a new system for classifying the status of MFH projects.
2. Project classification will be based on findings, violations, and defaults. Reporting of findings and violations will be based on a Servicing Office's review, analysis, and input.
3. All administrative levels of the Agency may review a project's classification and servicing record on-line or using MFIS3 reports. This eliminates monthly and quarterly classification paper reporting responsibilities.

Discussion:

1. MFIS3 project classification will be based on the following:
 - D Monetary default – Project is delinquent more than 60 days
Non-monetary default – Unresolved violation more than 60 days from the date of servicing letter #1
 - C Unresolved finding or violation
Unresolved violation less than 60 days from the date of servicing letter #1
 - B Finding or violation with an approved workout plan that is “on schedule”
 - A No unresolved finding or violation
2. The classification system uses terminology including “finding” and “violation”. It redefines others such as default, contact, and servicing letters. Understanding the following concepts are important to assure correct classification.
 - A **finding** is determined when the Agency “finds” that a borrower is not operating in accordance with the loan or grant agreement, Agency regulations, or applicable local, state, or federal laws. MFIS3 allows for specific predefined findings to be entered depending on the type of supervisory action where the Agency typically determines their occurrence. Attachment B-1 contains a preliminary list of findings by supervisory activity type. A final list will be available in MFIS3 training material. When findings are resolved, they are resolved on MFIS3 by recording an additional supervisory action.
 - A **violation** is a finding that the Servicing Office escalates because of its severity, or because of the type of servicing effort that will be used to obtain compliance. When the Agency designates a finding as a violation, it indicates a willingness to pursue the finding to the point of acceleration to have it corrected. MFIS3 provides a process for the Servicing Office to elevate a finding to a violation. For example:
 - If the Servicing Office is advised by a local health department that a major failure of the project's waste water disposal system will cause the project to be declared unfit for habitation, the Servicing Office may code the project in “violation” and begin to take immediate corrective servicing actions.

- If repeated documented efforts to correct a finding from a physical inspection, such as “broken windows and torn screens” has not resulted in the borrower taking steps to resolve the problem; the Servicing Office may escalate the finding to a violation. To implement this change in status, the Servicing Office will update MFIS3 and issue servicing letter #1 to begin the formal notification process to obtain borrower compliance.
- The term ***non-monetary default*** is re-defined to provide a more precise status based on Agency servicing efforts. MFIS3 will consider a project to be in non-monetary default 60 days after the issuance of servicing letter #1 and the borrower has not responded in a way to resolve the violation, either directly or through a workout plan.
- Projects with ***monetary defaults*** will be provided to MFIS3 from AMAS and are defined as those projects delinquent for more than 60 days. A monetary violation includes projects that have been accelerated and borrowers who are in bankruptcy.
- A servicing ***contact*** can mean a letter, document, visit, meeting, or phone call where servicing information is exchanged with the borrower.
- ***Servicing letters #1, 2 and 3*** are the serious servicing letters currently used by the Agency. Servicing letters have an impact on classification and should be used in conjunction with an effort to resolve a violation. When servicing letters are used, they must also be entered on MFIS3.

The classification system allows the Agency to focus on those projects which servicing offices consider truly at risk. The following is a brief description of how the Agency will view the classification of the portfolio:

- “Class D” projects are in default and may be taken into inventory, be lost to the program, or cause the displacement of tenants. Defaults can be monetary or non-monetary. Non-monetary defaults are those projects where a Servicing Office has notified the borrower of a violation using the Agency's three processing letter process, and the borrower has not addressed the violation to the satisfaction of the Servicing Office within 60 days of the first servicing letter. Agency reviewers in the Servicing, State or National Office will be alerted that the project is in jeopardy and should be available to provide further servicing assistance.
- “Class C” projects are projects with identified findings or violations. They include projects with violations where servicing letter #1 has been issued, but 60 days from the date of the servicing letter has not passed without a resolution. It is important to note that while the presence of a finding or violation is a normal occurrence in portfolio management, Agency reviewers will be concerned when findings and violations are carried for an extended period of time with no indication of Servicing Office resolution efforts. Projects under this status for an extended period of time will alert Agency reviewers to one or more of the following:
 - There may be workload or staffing issues related to resolving problems;
 - Findings may need to be elevated to a violation status to facilitate effective servicing;
 - Assistance from the State or National Office may be necessary to address the problem.
- “Class B” indicates that servicing steps have been taken and the borrower is cooperating to resolve identified findings or violations with the use of a workout plan.
- “Class A” projects have no unresolved findings or violations.

3. MFIS3 provides all administrative levels of the Agency with access to the servicing history of each MFH project. Rather than simply counting the number of “D’s” or “C’s” program managers and reviewers may focus on the servicing efforts being taken to resolve clearly identified findings and violations. In addition, program managers and reviews may also focus on unusually low occurrences of findings or violations. The National, State and Servicing Office will have the capability to generate, view, and print the classification reports as needed.

Loans may be reclassified on MFIS3 as findings and violations are determined.

Procedural Reference:

RD Instruction 1965-B, paragraph 1965.58 (a) (5) requires the management card system per RD Instruction 1905-A to assure compliance by borrowers with RD requirements. An unnumbered letter from the Acting Administrator for Rural Housing and Community Development Service dated March 20, 1995, implemented the Multi-Family Integrated System (MFIS) to replace the management system card (Form RD 1905-6). MFIS is an automated version of the management system card and has evolved into an integrated, relational database. The implementation of MFIS3 classification will be as described in this AN.

Implementation Directions:

It is the responsibility of each Rural Development Program Manager to assure that their Servicing Office correctly uses MFIS3 to properly and accurately classify MFH projects. State Directors are responsible to assure that MFIS3 classification accurately reflects the servicing status of their jurisdiction.

Supervisory Visit Requirements

Supervisory visit requirements are:

1. Servicing Offices will conduct an annual “walk-about” physical inspection.
2. Form RD 1930-11, “MFH Physical Inspection Report” will be used to record the results of the physical inspections performed by the Agency.
3. Servicing Offices may use the management and occupancy review and worksheet formats generated by MFIS3 as a voluntary field test for a replacement to the format provided by RD Instruction 1930-C, Exhibits G, G-1 and G-2.

Discussion:

1. **Annual “walk-about” Physical Inspection.** The annual physical inspection is an informal site review also known as a “walk-about”. Its purpose is to quickly determine if the project is in compliance with the Agency’s physical building standards. It is not to inspect for full compliance with all applicable maintenance standards, but to identify any potentially serious problems that may require immediate attention.

Physical inspections should be completed at least 90 days prior to the end of the borrower’s fiscal year. This will provide basic information that can be helpful in reviewing the borrower’s budget request for the coming year. Before visiting the site, a review of the borrower’s case file, previous physical reviews, most recent physical inspection report, tenant complaints (if applicable) and MFIS should be made to determine if there may be any particular issues with the project’s physical condition.

It is estimated this review will take approximately 30-60 minutes depending on the number of units in the project and the condition. The inspection will be conducted using the exterior side of the summary page of the RHS MFH Physical Inspection Report, provided that the worksheet for exterior standards is used to document “findings”. Based on the inspector’s findings, a full physical inspection may be necessary at this time or scheduled for the near future. The results of the walk-about inspection will be entered into MFIS3.

2. **Form RD 1930-11 “MFH Physical Inspection Report.”** The Agency is required to monitor the physical condition of each project it finances in order to ensure that the property maintains its value, tenants have housing that is decent, safe and sanitary, and environmental and civil rights requirements are maintained. Form RD 1930-11 was developed by Agency staff to assure that a consistent and objective assessment of a project’s physical status is implemented program-wide. The form incorporates “performance standards” to describe the physical condition a project should achieve. Data from the form documenting a project’s failure to meet performance standards will be entered into MFIS3 and used in monitoring project operations and in the classification process.

Form RD 1930-11 consists of three sections. The first section is the summary sheet that records pertinent project information as well as the summary findings from the exterior and interior physical standards worksheets. The second section records the results of the review of compliance with the exterior physical standards, and the third section records the results of the review of compliance with interior physical standards. There are 14 categories of physical standards with sub-items on each worksheet identified for review.

Directions for completing the worksheets are at the beginning of each section. The form requires the reviewer to make the determination of what previously would be noted as a deficiency or weakness, but now is to be reported as a “finding” or “violation”.

A “finding” is a failure to meet physical standard that should be corrected through routine procedures. A “violation” is a finding that is elevated either by its severity or the Agency’s inability to obtain a resolution from routine servicing methods.

If a “finding” or “violation” is identified in any sub-item of the 14 categories of physical standards, the Servicing Office will determine if the overall rating of that category should be coded a “finding” or “violation”. A category level violation should be only recorded if the Servicing Office intends to pursue the problem through the use of the MFH program's three servicing letters process. Elevating a finding to a violation will have an impact on the classification of a project. See Attachment B for a more thorough discussion of the MFIS3 classification process.

All three sections of the form will be completed for the triennial inspection. The worksheets for exterior and interior physical standards should be completed first. The summary page should be completed last to record the results of the physical inspection in preparation for entry into MFIS3. All findings must be documented on the inspection worksheets and must correspond to the available physical standards described.

3. The MFIS3 reports “Project Management and Occupancy Review,” “Project Management Review Worksheet,” “Occupancy Review Worksheet” and “Individual Tenant File Review Worksheet” all provide alternative formats to Exhibits G, G-1 and G-2 of RD Instruction 1930-C. The objective of the new format is to reduce redundant information and focus on key issues that define good project operations and occupancy management.

Procedural Reference:

1. RD Instruction 1930-C, paragraph 1930.119 (a) provides for visits to MFH project sites as necessary to accomplish the objectives of the loan or grant. To assure that the physical status of the portfolio is properly monitored, an annual physical inspection is now to be conducted except as provided for below in the implementation directions.
2. RD Instruction 1930-C, paragraph 1930.119 (b)(2)(ii) provides for using an alternative to the HUD Form 9822. To assure consistency in the assessment of the MFH portfolios physical status, the physical inspection segment of the triennial inspection will now be recorded on RD Form 1930-11, the MFH Physical Inspection Report.
3. RD Instruction 1930-C, paragraph 1930.119 (b)(1)(v) states that “Exhibits F, F-1, F-2, G, G-1, and G-2 should be used” during the supervisory visit. To help determine the effectiveness of a new reporting format, Servicing offices may use reports generated by MFIS3 on a voluntary basis.

Implementation Directions:

1. Servicing Offices are to conduct an annual “walk-about” physical inspection. Once every three years, usually in conjunction with a full supervisory visit, a complete physical inspection will be conducted using both the interior and exterior physical inspection worksheets. When a complete physical inspection is not to be performed, the Servicing Office will complete a short “walk-about” inspection using the exterior inspection worksheet only.

If the Servicing Office completes a physical inspection and has no findings regarding the physical status of a project, the following annual walk-about may be omitted. However, each project must receive either a walk-about inspection or full physical inspection at least once every two years.

2. Form RD 1930-11 will be used to record the results of the physical inspections conducted by the Agency. If a physical inspection is conducted by a housing provider other than the Agency that is associated with an RHS financed MFH project, the Agency may use those results provided that the Servicing Office is satisfied that the results of the inspection are acceptable. Results of all physical inspections will be entered into MFIS3.

3. Servicing Offices may use the management and occupancy review and worksheet formats generated by MFIS3 as a voluntary field test for a replacement to the format provided by RD Instruction 1930-C, Exhibits G, G-1 and G-2. Comments on issues found during this voluntary field test should be directed to Melinda Price of the Multi-Family Housing Servicing and Project Management Division at mmprice@rdmail.rural.usda.gov.

Changes to the Project Budget Approval Process

Program Changes:

1. When the Agency reviews a proposed project budget submitted by a borrower on Form RD 1930-7, the Servicing Office will enter the proposed budget on MFIS3 and use the analysis information provided by MFIS3 in the budget approval review.
2. Borrowers will not submit and the Agency will not review current year “actuals” at the time of the proposed budget review.
3. Revised Form RD 1930-7 will include an annual capital budget. Revised Form RD 1930-7 will be issued under a separate Procedure Notice.

Discussion:

1. MFIS3 provides a powerful process to prepare information for the Agency’s review and analysis of proposed project budgets. The results of this process are available on-line or through a system generated report. Once converted to MFIS3, Servicing Offices must use the MFIS3 analysis information to review project budgets. The MFIS3 analysis process should be the primary mechanism for budget review. Additional information may be considered when the Servicing Office deems that it is relevant to protect the financial integrity of the MFH project. Budget approval decisions will be based on the consideration of the MFIS3 analysis information and any additional relevant issues. Attachment D-1 documents the information MFIS3 prepares for analysis.
2. MFIS3 will compare the proposed budget with the preceding year’s approved budget for the project and a series of budget norms designed to determine the comparability of the proposed budget’s figures. Attachment D-2 discusses these norms in depth. Borrowers will now only be required to submit actual budget figures with the audit or MFH Borrower Balance Sheet, Form RD 1930-8, after the end of the borrower’s fiscal year.
3. Borrowers will submit their proposed use of funds for capital items with the proposed budget on Form RD 1930-7. These figures will be used to anticipate reserve account usage prior to the start of the borrower’s fiscal year. Capital items on an approved proposed budget do not constitute an approval of reserve account use. Requests for the use of reserve account funds must be approved as a separate action in accordance with current RD Instruction 1930-C, Exhibit B, Paragraph XIII B 2 c. Borrowers will submit actual expenditures for capital items with the audit or MFH Borrower Balance Sheet, Form RD 1930-8, after the end of the borrowers’ fiscal year.

Procedural Reference:

1. RD Instruction 1930-C, Exhibit C, V A 1 requires the Agency to review all budget material submitted by the borrower. Beginning with the FY 2001 project budget approvals, the Agency will perform the review in using the guidance provided in this AN.
2. RD Instruction 1930-C, Section 1930.122 (b) (1) (ii) requires the annual project budget to be prepared in accordance with the instructions of Form RD 1930-7. The instructions of the revised Form RD 1930-7 no longer require that the “actual” column be completed at the time a proposed budget is being prepared.
3. Form RD 1930-7 is revised to include a new Part VI for “Capital Budgeting” Part VI is to be completed in accordance with the form’s Instructions.

Implementation Directions:

1. The Servicing Office will enter the proposed budget submitted by the borrower on Form RD 1930-7 into MFIS3. The MFIS3 analysis information will provide the Servicing Office with the difference between the current proposed budget and the previous proposed budget, and the difference between the current proposed budget and system generated norms that match the profile of the project being studied. The Servicing Office will use these results as a primary source of information for their review of the borrower’s proposed budget.
2. The Servicing Office will use the proposed budget approval process to assure that the borrower is properly planning to address project needs and operate using reasonable and comparable expenses. The Agency’s review of actual budget information for compliance related issues will be performed when audited or reviewed actual budgets are submitted after the end of the borrower’s fiscal year.
3. An annual capital budget will now be completed and submitted by borrowers. It will be reviewed and approved by the Agency as part of Form RD 1930-7.

MFIS3 Analysis Items for Proposed Budgets

1. MFIS3 will perform the following analysis for each proposed budget:

- Is there more than a 10% difference between the proposed and previous budget?

From Part I

- Cash Sources
- Cash Uses
- Net Cash
- Unrestricted Cash

From Part II

- Subtotal M&O
- Subtotal Utilities
- Subtotal Administrative
- Subtotal Taxes and Insurance
- Total O&M

From Part III

- Transfer from Reserve

Further Analysis

- Positive Cash Flow
- Correct Reserve Deposit
- Part III Capital Use matches Part I
- First Year of Operation
- 2% Money properly deposited

- Is there more than a 10% difference between the proposed budget and 4 different sets of MFIS3 norms, on the following items? Norm 1 (narrow by state), norm 2 (narrow by region), norm 3 (broad based by state), and norm 4 (broad based by region).

From Part I

- Cash Sources
- Cash Uses
- Net Cash
- Unrestricted Cash

From Part II

Subtotal M&O

Subtotal Utilities

Subtotal Administrative

Subtotal Taxes and Insurance

Total O&M

From Part III

Transfer from Reserve

2. On MFIS3 screens the on-line analysis for proposed budgets will appear as follows:

Cash Sources -	prpsd to prvs 10% dif	(Failed or Passed will be indicated)
Cash Uses -	prpsd to prvs 10% dif	
Net Cash-	prpsd to prvs 10% dif	
Unrstd Cash-	prpsd to prvs 10% dif	
Subttl M&O-	prpsd to prvs 10% dif	
Subttl Util-	prpsd to prvs 10% dif	
Subttl Admn-	prpsd to prvs 10% dif	
Subttl T&I-	prpsd to prvs 10% dif	
Total O&M-	prpsd to prvs 10% dif	
Trans frm resrv -	prpsd to prvs 10% dif	
Positive Cash flow		
Correct reserve deposit		
Part III Capital Use matches Part I		
First Year of Operation		
2% Money properly deposited		
Cash Sources -	prpsd to nrm1 10% dif	
Cash Uses -	prpsd to nrm1 10% dif	
Net Cash-	prpsd to nrm1 10% dif	
Unrstd Cash-	prpsd to nrm1 10% dif	
Subttl M&O-	prpsd to nrm1 10% dif	
Subttl Util-	prpsd to nrm1 10% dif	
Subttl Admn-	prpsd to nrm1 10% dif	
Subttl T&I-	prpsd to nrm1 10% dif	
Total O&M-	prpsd to nrm1 10% dif	
Trans frm resrv -	prpsd to nrm1 10% dif	
Cash Sources -	prpsd to nrm2 10% dif	
Cash Uses -	prpsd to nrm2 10% dif	
Net Cash-	prpsd to nrm2 10% dif	
Unrstd Cash-	prpsd to nrm2 10% dif	
Subttl M&O-	prpsd to nrm2 10% dif	
Subttl Util-	prpsd to nrm2 10% dif	
Subttl Admn-	prpsd to nrm2 10% dif	
Subttl T&I-	prpsd to nrm2 10% dif	
Total O&M-	prpsd to nrm2 10% dif	
Trans frm resrv -	prpsd to nrm2 10% dif	
Cash Sources -	prpsd to nrm3 10% dif	
Cash Uses -	prpsd to nrm3 10% dif	
Net Cash-	prpsd to nrm3 10% dif	
Unrstd Cash-	prpsd to nrm3 10% dif	
Subttl M&O-	prpsd to nrm3 10% dif	
Subttl Util-	prpsd to nrm3 10% dif	
Subttl Admn-	prpsd to nrm3 10% dif	
Subttl T&I-	prpsd to nrm3 10% dif	
Total O&M-	prpsd to nrm3 10% dif	
Trans frm resrv -	prpsd to nrm3 10% dif	
Cash Sources -	prpsd to nrm4 10% dif	
Cash Uses -	prpsd to nrm4 10% dif	
Net Cash-	prpsd to nrm4 10% dif	
Unrstd Cash-	prpsd to nrm4 10% dif	

Subttl M&O- prpsd to nrm4 10% dif
Subttl Util- prpsd to nrm4 10% dif
Subttl Admn- prpsd to nrm4 10% dif
Subttl T&I- prpsd to nrm4 10% dif
Total O&M - prpsd to nrm4 10% dif
Trans frm resrv - prpsd to nrm4 10% dif

(Prpsd = Proposed) (Prvs = Previous) (Dif = Difference) (Nrm – Norm)

Reserve Account Supervision

Program Changes:

1. An amount may be entered on MFIS3 to indicate the long-term capital needs of a project as determined by a capital needs assessment.
2. All authorized withdrawals of reserve account funds will be treated the same, regardless of the purpose for the use of funds. Specifically, the Agency will not require withdrawals for operating purposes to be paid back to the reserve account prior to allowing a return to owner (RTO).
3. To assure consistency, MFIS3 terminology will now be used to describe the status of reserve accounts.

Discussion:

1. The compliance status of reserve accounts (ahead or behind schedule) is not always a good indicator of an MFH project's ability to have internally generated funds available to address long term-capital needs. A capital needs assessment is a recognized process for determining long term capital needs of physical property and developing a plan to have financial resources in place to address those needs as they come due. There are several individuals and companies that provide this service nationwide. In addition, Agency staff and borrowers have prepared informal capital needs assessments when considering an increase to reserve account requirements. HUD recently required a similar review referred to as a "comprehensive" needs assessment to be performed on its portfolio. Results of a capital needs assessment may now be entered into MFIS3.
2. MFIS3 will consider all Agency approved withdrawals as "authorized" without restrictions for repayment prior to authorizing a return to owner (RTO). This policy change is implemented to reduce over-regulation of borrower operations. Projects required to use reserve funds for operating expenses have a cash flow problem and the issue of receiving a RTO should not be relevant. Agency policy has been and continues to be that reserve funds may be used for operating expenses only under extreme or unusual conditions. It is important to note that Form RD 1930-7 now includes a "part" devoted to budgeting for capital needs to assure that the borrower has a responsible plan for maintaining the property. The use of reserve funds to pay an RTO continues to be an authorized use of reserve funds. However, when determining the required reserve balance amount on MFIS3, an RTO withdrawal amount will not be included in the calculation.

For further clarification, the primary use of reserve account funds is to address capital needs of the project.

- It is not an acceptable budgeting or management practice to routinely seek to use reserve account funds to address operating costs or operating cost overruns. Borrowers are responsible for providing project management that can prepare reasonable budget forecasts that do not jeopardize the ability of the project to address needed capital expenses. In accordance with RD Instruction 1930-C, Exhibit B, XIII B 2 c (5), the Agency may reject reserve account requests for operating expenses that are the result of unrealistic budget estimates.
- RD Instruction 1930-C, Exhibit B, XII A 5 requires that borrowers pay critical operating and maintenance expenses prior to meeting reserve account requirements. It is not an acceptable budgeting or management practice to make a required reserve deposit prior to meeting critical operating and maintenance expenses.
- The Agency may require borrowers to replace project management that fails to practice responsible budgeting or management practices.

3. To clarify reserve account terminology, MFIS3 uses the following terminology:

- ***Fully funded amount*** – The amount at which point the reserve account will be considered fully funded per the loan agreement.
- ***Annual deposit amount*** – The amount of funds, which must be deposited on an annual basis to the reserve account, per the loan agreement.
- ***Capital need amount*** – Total amount to address capital needs by the date entered; per a capital needs assessment.
- ***Account balance amount*** – The actual reported borrower account balance as of the date displayed.
- ***Required balance amount*** – The amount that the reserve account should contain at the point in time closest to the date associated with the account balance amount. This represents the total deposits minus authorized withdrawals.
- ***Total authorization amount*** – Total amount of funds authorized to be withdrawn from the reserve account.
- ***Total withdrawal amount*** – Total amount of funds withdrawn from the reserve account. This field should never be greater than the total authorization field.
- ***Total budget withdrawal amounts*** – Total amount of funds defined within the budget that is expected to be withdrawn from the reserve account.

Procedural Reference:

1. RD Instruction 1930-C, Exhibit B, Paragraph X. establishes a borrower's responsibility to assure that proper maintenance is performed and planned. Capital needs assessments may be a means for determining future maintenance needs and are considered an allowable project expense.
2. RD Instruction 1930-C, Exhibit B-9, is an optional reserve account withdrawal approval letter for use by the Agency.

3. MFIS3 terminology is consistent with reserve account guidance found within RD Instruction 1930-C, Exhibit B, Paragraph XIII B 2 c.

Implementation Directions:

1. Borrowers are encouraged to obtain a capital needs assessments to determine the actual level a project's reserve account should reach to meet the project's individual needs. Once determined, loan agreements should be appropriately modified to reflect a new fully funded level. The Servicing Office is to enter the results of any capital needs assessments performed for a MFH project into MFIS3. The fully funded amount and the fully funded date are to be entered.
2. With the issuance of this AN, the Agency should no longer use the middle paragraph of Exhibit B-9 when approving withdrawals from the reserve account for operating purposes. When entering the authorization amount for RTO withdrawals on MFIS3, the Servicing Office will enter zero in accordance with MFIS3 training guidance.
3. MFIS3 terminology will be used to describe reserve account status. Terminology described in this AN is also available in the MFIS3 users guide.

Change to the Review of Actual Project Operating Income and Expense Figures

Program Changes:

When the Agency reviews actual operating income and expense figures (actuals) submitted by a borrower on Form RD 1930-7 with year-end financial information, the Servicing Officer will enter the actuals on MFIS3 and use the analysis information provided by MFIS3 in their review of borrower compliance with program regulations.

Discussion:

MFIS3 uses a powerful process to prepare information for the Agency's review and analysis of project budgets with actual figures. The results of this process are available on-line or through a system generated report. Servicing Offices must use the MFIS3 analysis information to review actual budgets once converted to MFIS3. The MFIS3 analysis process should be the primary mechanism for budget review; however additional information may be considered **when the** Servicing Office deems that it is relevant to protect the financial integrity of the MFH project. Budget compliance decisions, which may result in findings or violations, will be based on the MFIS3 analysis information and any additional relevant issues. Attachment F-1 documents the information MFIS3 prepares for analysis.

Procedural Reference:

RD Instruction 1930-C, Section 1930.122 (b) (4) (iv) requires the Agency to review all financial material submitted by the borrower with the annual audit reports or verifications of reviews. Beginning with the FY 2000 submittals, the Agency will perform the review of the actual budget figures provided on Form RD 1930-7 using the guidance provided in this AN.

Implementation Directions:

The Servicing Officer will enter the actual budget submitted Form RD 1930-7 into MFIS3. The MFIS3 analysis information will provide the Servicing Officer with the difference between the actual budget and the proposed budget as well as the difference between the actual budget and system generated norms that match the profile of the project being studied. The Servicing Officer will use these results as a primary source of information for review of the borrower's actual budget.

MFIS3 Analysis Items for Annual and Year-To-Date Actual Budgets

1. MFIS3 will perform the following analysis for each actual budget and year-to-date actual budget received from the borrower:

- Is there more than a 10% difference between the actual and the proposed budgets?

From Part I

Cash Sources
Cash Uses
Net Cash
Unrestricted Cash

From Part II

Subtotal M&O
Subtotal Utilities
Subtotal Administrative
Subtotal Taxes and Insurance
Total O&M

From Part III

Transfer from Reserve

Further Analysis

Positive Cash Flow
Correct Reserve Deposit
Part III Capital Use matches Part I
First Year of Operation
2% Money properly deposited

2. The on-line analysis for year-end actual and year-to-date actual budgets will appear on MFIS3 screens as follows:

Cash Sources
Cash Uses
Net Cash
Unrestricted Cash
Subtotal M&O
Subtotal Utilities
Subtotal Administrative
Subtotal Taxes and Insurance
Total O&M

Transfer to reserve

Transfer from reserve

Positive Cash flow

Correct reserve deposit

Part III Capital Use matches Part I

First Year of Operation

2% Money properly deposited